

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-796
October 30, 1998

BANGOR HYDRO ELECTRIC COMPANY
Petition for Affiliated Approval
Needed in Connection with Bangor
Gas Company Transaction

ORDER
(Phase II)

WELCH, Chairman; NUGENT, and DIAMOND, Commissioners

I. SUMMARY OF DECISION

In this Order, we approve an investment of \$1,224,000 by Bangor Hydro-Electric Company (BHE) in Bangor Gas Company, LLC (BGC).¹ This amount represents \$624,000 already expended by BHE in development costs, and an additional \$600,000 for which BHE has sought authority to invest. We further clarify that BHE must seek our prior approval for all monies expended on BGC, whether expenditures are characterized as investments, development costs, or otherwise.²

II. PROCEDURAL HISTORY

On October 29, 1997, BHE filed, together with BGC, a Consolidated Petition in which BHE requested authority to participate in Bangor Gas, and Bangor Gas requested authorization to provide gas service as a public utility gas company serving the greater Bangor area. The companies' motion to consolidate these two cases was denied, and accordingly BHE's petition and BGC's petition have proceeded in separate dockets. BHE sought authorization to invest \$2.5 million in Bangor Gas, through a wholly-owned subsidiary. Parties in this case included BHE, the Public Advocate, BGC, Maritimes and Northeast Pipelines, LLC (Maritimes), and Central Maine Power Company (CMP).

On March 26, 1998, we issued an Order Rejecting Stipulation and Approving Second Revised Stipulation (Phase I Order). In that Order, we rejected the original stipulation filed on behalf

¹ BHE's investment in BGC will be through its wholly-owned subsidiary Penobscot Natural Gas (PNG). We approved the creation of the subsidiary in our Order Rejecting Stipulation and Approving Second Revised Stipulation, Docket No. 97-796, (Mar. 26, 1998), Phase I Order.

² We decline to approve the stipulation submitted to us concerning the \$600,000 request by BHE because it fails to address the development costs already expended.

of BHE, BGC, Maritimes, and the Public Advocate. We concluded that the original stipulation was inconsistent with the findings the Commission is required to make pursuant to 35-A M.R.S.A. § 708 and inconsistent with the Commission policy set forth in the Commission's order provisionally adopting Chapter 820 of the Commission's rules.

We instead approved the Second Revised Stipulation filed subsequently by the same parties. The Phase I Order approved an investment by BHE of its development costs associated with BGC plus a cash investment of up to \$2.5 million, conditioned upon BHE's demonstrating in a subsequent filing that it was in "sound financial condition." The Phase I Order also allowed BHE to form a subsidiary for the purpose of investing in BGC. Finally, the Second Revised Stipulation, approved in the Phase I Order, contained provisions to hold ratepayers harmless from the negative consequences of BHE's investment.

On July 7, 1998, BGC made a supplemental filing seeking authority to make a cash investment of \$600,000 in its wholly-owned subsidiary, Penobscot Natural Gas (PNG) so that PNG could invest in BGC. The Commission's Advisory Staff (Advisors) and the parties conducted discovery. The Public Advocate filed comments stating that he neither opposed nor supported the \$600,000 cash investment. The Advisors issued a Bench Analysis on September 4, 1998.

Coincidentally on September 4, 1998, counsel for BHE filed a stipulation on behalf of BHE, BGC and Maritimes. These parties agreed that BHE should be permitted to invest \$600,000 in cash in PNG for the purpose of PNG's investing the same amount in BGC. No party opposed the Stipulation. On September 11, 1998, the Commission held a hearing on BHE's petition for authority to invest in BGC. BHE, BGC and the Public Advocate participated in the hearing. On September 12, the Examiner issued a procedural order asking the parties to address in their briefs matters relating to Section 3.2 of the Bangor Gas Company, LLC, Amended and Restated Operating Agreement (Operating Agreement). BHE, BGC and the Public Advocate filed briefs on whether BHE's requested petition should be granted.

III. STANDARD FOR DETERMINING FINANCIAL SOUNDNESS

- A. Standards Set Forth in 35-A M.R.S.A. § 708, Ch. 820, and the Phase I Order.

Section 708 of Title 35-A provides that no reorganization may be approved unless the applicant establishes that the reorganization is consistent with the interests of the utility's ratepayers and investors. Section 708 further states that in granting its approval for a reorganization, the Commission shall impose such terms, conditions and requirements as are necessary to protect the interests of ratepayers, including, in relevant part, provisions which ensure:

- ♦ that the utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is not impaired;
- ♦ that the ability of the utility to provide safe, reasonable and adequate service is not impaired;
- ♦ that the utility's credit is not impaired or adversely affected; and
- ♦ that reasonable limitations are imposed upon the total level of investment in non-core ventures.

35-A M.R.S.A. § 708(2)(A).

Section 708 thus sets forth the requirement that ratepayers be insulated from the negative effects of a utility's investment in non-core activities. We have determined in Chapter 820 and in our Phase I Order that, unless the utility is in sound financial condition, it is impossible to insulate ratepayers from the negative consequences of an investment. In our Phase I Order, we stated:

Unless the utility is in sound financial condition, provisions requiring a utility to hold ratepayers harmless for the negative consequences of a utility's investment in non-core activities do not provide adequate protection. Simply disallowing costs associated with the investment for a company that is already financially troubled may result in further harm to the utility's ratepayers. In addition, in a rate case it may be difficult to separate and quantify the adverse effects on credit and access to capital resulting from a non-core investment from other circumstances that may be contributing to the utility's troubled financial circumstances.

Order at 7. We cited our recent characterizations of BHE's financial condition as "relatively precarious." We concluded that:

because BHE has not shown that the Company is or will be in sound financial condition, BHE has not established that the reorganization is consistent with the interest of the utility's ratepayers and investors as required by 35-A M.R.S.A. §708(2). Because of the Company's failure to establish that it is in sound financial condition, we also cannot make the requisite determinations pursuant to section 708 of Title 35-A.

Order at 7.

By contrast, we found the Second Revised Stipulation consistent with the concern expressed in section 708 and Chapter 820 that ratepayers cannot be fully insulated against negative effects of utility investments in non-core activities unless the utility is financially sound:

The Second Revised Stipulation, on the other hand, requires BHE to demonstrate that it is in sound financial condition consistent with the requirements of Chapter 820, as finally adopted, and section 708 of Title 35-A. Chapter 820 as provisionally adopted bars (absent a waiver) investment in an affiliate by a utility that has not attained investment grade bond rating or that has filed for or been granted a temporary rate increase pursuant to 35-A M.R.S.A. §1322. If the rule, as finally adopted, does not contain these restrictions, we would still determine pursuant to section 708 of Title 35-A whether BHE is financially sound.

Order at 8.

Chapter 820, as finally adopted, does not require a utility seeking permission to invest in a regulated non-core venture to have an investment grade bond rating. Instead, the rule provides that a proposed investment by a utility in a regulated non-core venture is governed by section 708 of Title 35-A. Thus, the Commission must determine case-by-case whether the utility is financially sound. At issue in this case are first, the factors we should consider in determining whether a utility is sufficiently financially sound to justify allowing the proposed investment, and second, whether BHE meets that test.

B. Summary of Standard

We conclude that the standard for determining financial soundness should take into consideration the size of the investment in relation to the overall financial health of the utility. In judging financial health, we will look first to objective financial indicators, such as the ratios used in the Bench Analysis. If the indicators show that a company's financial condition is less than robust (as demonstrated, for example, by ratios consistent with investment-grade bond ratings), we will turn to a more general examination of the company's financial condition to ascertain whether the investment should nevertheless be permitted. Our analysis of BHE's condition is detailed below.

C. Factors in Determining Financial Soundness

1. Financial Ratios

The Bench Analysis provides a discussion of specific financial ratios used by the financial community in assessing the financial health of a business. The ratio analysis examines several of BHE's financial ratios, including its leverage ratio (total debt ratio) and its various interest coverage and cash flow ratios, using the Company's most current financial forecast. These ratios assist in evaluating the Company's long-term risk and return characteristics and thus its ability to attract capital in the future. According to one study, "the most important variables used by investment bankers to evaluate the risk of public utilities were the times interest earned [pre-tax interest coverage] and overall cash flow coverage ratios."³ The analysis of financial statements and ratios provides a means of objectively measuring a utility's (or any firm's) financial health. In the words of another scholar:

Analysts have always been interested in using financial ratios to identify which firms might default on loans or declare bankruptcy. Several studies have attempted to identify a set of ratios for this purpose The analysis involves examining a number of financial ratios expected to reflect declining liquidity for several years (usually 5 years) prior to the declaration of bankruptcy. . . . Some of the models have been able to properly classify over 80% of the firms 1 year prior to failure, and

³Roger A. Morin, *Regulatory Finance: Utilities' Cost of Capital*, at 79 (2nd ed. 1994).

achieve high classification results 3 to 5 years before failure.⁴

Among the ratios identified as valuable in predicting severe financial distress are cash flow to total debt ratio, and debt to total capital. These ratios are shown on Exhibit 7 and Exhibit 8 to the Bench Analysis. The Bench Analysis evaluated these ratios using both historical data and the Company's own forecast. In addition, the Bench Analysis adjusted these ratios based on the possibility that BHE's allowed rate of return on equity (ROE) would be lower after the year 2000 than the 12.75% modeled by BHE.

BHE and BGC claim that the Legislature's amendment to Chapter 820 prevents us from relying on an investment grade bond rating to determine whether to allow a proposed investment in a regulated non-core venture. They claim, therefore, that the Bench Analysis is irrelevant to the determination of whether BHE should be allowed to make the proposed investment.

Their argument goes too far. While the Legislature clearly contemplated that we would not rely mechanistically on particular financial indicators, nothing in Chapter 820, as finally adopted, precludes the use of any particular tool in judging financial health. The Legislature was concerned that a utility seeking to invest in a regulated affiliate not be barred from the investment simply because it was rated below investment grade. Accordingly, the Legislature directed the Commission to determine case-by-case whether allowing an investment in a regulated non-core venture may be granted pursuant to section 708. We amended our rule accordingly. We disagree with BHE that the case-by-case approach required by the amendment to Chapter 820 prevents us from considering generally accepted financial indicators for assessing a utility's financial health.

In addition to examining financial ratios, we conclude it is appropriate to consider (with appropriate weight, as discussed in Section 4 below) other indicia of financial condition including credit reports, lender authorizations, funds from asset sales, information on monthly financial statements and financial forecasts, the consummation of advantageous financial transactions, and the size of the investment relative to the size of the company and its overall condition.

We disagree with BHE and BGC that the Commission need look only at the narrow question of whether BHE could

⁴Frank K. Reilly, *Investment Analysis and Portfolio Management*, at 367 (4th ed. 1994).

survive, in the short term, the loss of its entire investment. Although such information is helpful in determining the impact of the investment, it cannot end our inquiry. Simply showing that the impact on earnings and cash flow is small does not address the question of whether such a loss, taken in the context of overall financial health, could nevertheless be detrimental to ratepayer interests. We have already determined that it is impossible to insulate ratepayers fully from the negative effects of an investment by a utility that is not financially sound.

In Phase I of this case, for example, we determined that the Company's finances were weak enough to prevent us from being able to find that even an investment of \$600,000 in cash and \$375,000 in development costs was consistent with the findings we were required to make under section 708. However, under BHE's analysis, we simply would look at the incremental change in earnings and cash flow before and after the investment. If the impact were small, we would be required to allow the investment, even if the Company's financial condition was precarious.

We decline to adopt BHE's approach. The determination of the impact of the investment on BHE's credit, access to capital, and ability to provide safe, reasonable and adequate service cannot be separated from a determination of the utility's financial health.

IV. BHE'S FINANCIAL CONDITION

A. Financial Ratios

The Bench Analysis submitted in this case provided a statistical analysis and a ratio analysis. The statistical analysis identified a peer group of comparable companies for BHE and used their current bond ratings as a proxy for BHE's financial health. The statistical analysis calculated a total of six ratios, or "risk measures" and compared BHE against the Value Line (Standard Edition) universe of 84 electric utilities over the 3-year period 1995, 1996, and 1997. This analysis showed that BHE's peer companies were primarily investment grade but that BHE closely resembled three of the four non-investment grade utilities in the peer group.

The Bench Analysis also provided a ratio analysis. The ratio analysis calculated actual ratios for BHE for the period from 1995 through 1997 and also its forecasted ratios for 1998, 1999, 2000, and 2001 based on the projections the Company

provided us in its initial filing. These ratios are: (1) Net Cash Flow to Capital Expenditures, (2) Pre-tax (or EBIT) Interest Coverage, (3) Funds from Operations (FFO) Interest Coverage, (4) Funds from Operations (FFO) to Total Debt, and (5) Total Debt as a Percent of Total Capital. Although the statistical analysis is useful to demonstrate BHE's financial condition at the time of the Phase I Order for the purpose of comparing it to current or projected performance, we primarily focus on the use of the ratio analysis to evaluate BHE's projected financial performance for the period from 1998 to 2001.

The Bench Analysis highlighted the overall weakness of BHE's actual (1995-1997) financial risk ratios, including its leverage ratio (total debt ratio) and its various cash flow/interest coverage ratios using the Company's most current financial forecast. The analysis found that with the exception of net cash flow to capital expenditures, BHE's actual ratios for 1997 generally fall within the lower end of the BB ranges based on S&P's published benchmarks. The Bench Analysis also looked at BHE's financial ratios for the forecast period from 1998-2001. The analysis noted that the ratios on the whole show improvement over recent historical results but continue to indicate areas of weakness.

Finally, the Bench Analysis pointed out that the forecast is based on a return on equity of 12.75% (as set in BHE's most recent rate case, Docket No. 97-116). If BHE's allowed rate of return on equity starting in the year 2000 were reduced by, for example, 200 basis points, BHE's interest coverage and total debt ratios would suggest an above average level of risk in 2000 and 2001. The analysis further noted that BHE's forecasts could change as a result of the divestiture of generation assets since the Company has chosen to use book value for the purposes of modeling their sale. The analysis noted the possibility that BHE's position could improve dramatically if, like CMP and MPS, the generation asset divestiture indicated values significantly above book.

BHE and BGC are critical of the Bench Analysis. BHE argues that the Bench Analysis should have considered the reason for BHE's high level of debt, should have used forecasted data rather than historical data, and was not properly supported. BHE argues that the Bench Analysis should have determined financial condition solely in relation to the required filings in the Phase I Order. BGC asserts that the analysis is speculative and applies the wrong standard.

We disagree with BHE that the Bench Analysis should be discounted because it does not address the fact that BHE's high

debt level results from the buyout of purchase power contracts. BHE contends that as a result of the buyouts, it reduced its overall risk but necessarily increased its debt. We do not dispute that there were benefits to the buyouts; we merely observe that the overall risk of a company is the combination of both its business risk and its financial risk,⁵ and that, while the buyouts reduced business risk, they simultaneously (though not necessarily to the same degree) increased financial risk.

In our Order in Docket No. 97-116, we stated that "BHE's business and financial risk is affected by a number of unique factors, such as the sizable Ultrapower buyout, Maine Yankee's operating problems (which led to its recent closure), its limited financial flexibility in recent months, and other factors. . . ." *Bangor Hydro-Electric Company, Proposed Increase in Rates*, Docket No. 97-116, February 9, 1998, Order at 45. In determining that BHE's overall risk profile merited an allowed rate of return on equity (ROE) of 12.75%, we stated:

BHE has operated in a difficult risk environment for a number of years. Relevant risk factors include: (1) a relatively weak economy in its service territory; (2) substantial purchased power commitments (albeit moderated by the recent buyout of its Ultrapower contract, which, however, has increased its financial leverage significantly); (3) increasing power costs as a result of the recent closure of Maine Yankee; and (4) its elimination of its common dividend. At the present time, BHE has a high degree of financial leverage (as evidenced by a common equity ratio of about 27%) and very little financial flexibility, which severely limits BHE's ability to raise additional debt or equity capital at a reasonable cost.

⁵ Business risk has been defined as "the uncertainty of income that is caused by the firm's industry. In turn this uncertainty is due to the firm's variability of sales due to its products, customers, and the way it produces its products". Reilly at 342. Financial risk is defined as "the additional uncertainty of returns to equity holders due to the firm's use of fixed obligation debt securities. This financial uncertainty is in addition to the firm's business risk." Id. at 345

Id at 53. We note that BHE's own testimony in Docket No. 97-596 concludes that "investors consider Bangor Hydro to be a security with above average total and market risk."

Thus, although the buyouts are financially beneficial compared to the purchase power agreements, BHE's high debt levels remain a concern. We determine that the degree of BHE's financial leverage is a factor we consider in this case and will continue to consider in future filings for section 708 approval.

BHE also suggests that the Bench Analysis should be rejected because the "Bench offered no evidence to suggest that the formula it followed is at all consistent with the process followed by the rating agencies." We do not rely on the Bench Analysis, however, to arrive at a bond rating for BHE. The point of the Bench Analysis, as we interpret it, is that the analysis of financial statements and the resulting ratios are tools that are commonly employed by bankers, credit rating agencies, and both bond and equity investors in their investment decisions. BHE has acknowledged that it is appropriate for the Commission to look at these ratios in determining the Company's financial health. The Bench Analysis does not attempt to re-create a bond rating analysis. In addition to quantitative analysis, a bond rating analysis considers such qualitative factors as the ability of the management team, the regulatory climate in utility's operating territory, fuel/power supply and non-utility activities. The use of the bond rating benchmarks for specific ratios, however, does assist in assessing the overall financial health and level of risk of a utility. We do not imply that if one of the ratios falls outside the range, we would reject a petition for approval to invest. The use of these benchmarks simply provides a starting point in our analysis of financial soundness.

Finally we reject the claim that the Bench Analysis is flawed because it relied on historical data. The ratio analysis for 1998 through 2001 is based on BHE's financial projections for this period.

We now turn to other evidence that can guide our assessment of BHE's financial condition, and our determination of whether that financial condition justifies our approval of the proposed investment.

B. August Financial Statements

At the hearing, Mr. Samp alluded to financial results for the months of July and August. Although BHE did not offer these results into the record, we take official notice of the

monthly financial statements for August 1997, March 1998 and August 1998. MPUC Rules Ch. 110 § 927. Relevant portions of these statements are appended as Exhibit 1. Our examination indicates that the Company's financial condition has shown some improvement in the past year and noticeable improvement between the March and August 1998 financial statements. From these data, we discern a trend toward improved financial health. While the financial statements do not contain audited results, they reasonably reflect the Company's financial position. Exhibit 2 shows the factors that we considered in reaching our conclusion.

The indicators that are related to the Company's income statement all show improvement from a year ago and also from March of this year. Specifically, fully-diluted Earnings Per Share (EPS) for the 12 months ended August 1998 are up more than four times from the August 1997 results. The EPS results for the 12 months ended March 1998 were negative. Net Income for the 12 months ended August 1998 is nearly three times the amount shown for the 12-month period ending in August 1997 and is nearly five times the level reported for the 12-month period ending in March 1998. Retained Earnings showed an increase of over \$5 million from August 1997 to August 1998, and was up by about \$4.5 million from March 1998. Company-reported Return On Equity (ROE) increased from 0.88% in August 1997 to 4.73% at August of 1998; the ROE had been at negative 0.04% at the March 1998 reporting period. All these measures of operating results have moved in a positive direction for BHE after descending to very depressed levels from the summer of 1997 through the spring of 1998.

In addition, the Company's balance sheet showed greater stability. The Company's Book Value per Share increased from \$14.66 at August 1997 to \$14.76 at March 1998 and further climbed to \$15.64 at August 1998. While the Company's cash flow from operations and investing activities declined from \$15.2 million for the eight months ended August 1997 to \$2.8 million for the same period in 1998, the amount of cash on hand increased from \$0.116 million at August 1997 to \$1.536 million at March 1998 and to \$2.572 million at August 1998.

Finally, we looked at the interest coverage ratios reported by BHE. Its Bond Interest Coverage Ratio was 2.63X at August 1997, 2.65X for March 1998, and 3.06X at August 1998. The Company's Net Earnings Coverage ratio stood at 1.04X at August 1997 and 1.09X in March 1998, but it increased to 1.38X at August 1998. In these results we also see slow improvement from some rather depressed levels.

While the results reported by BHE at August 1998 do not show that BHE has achieved robust financial health, they suggest that the Company's position is no longer as precarious as it was

when the Commission granted the Company's request for emergency rates in 1997 and a sizable permanent rate increase in 1998.

C. Credit Report

BHE's February 1998 private letter credit report showed an upgrade of the Company's corporate credit rating from BB- to BB. According to the rating from Standard & Poor's, the rating reflects:

the utility's somewhat below average business risk profile and an improving, albeit still weak, financial profile when adjusted for off-balance sheet purchased power obligations. The poor qualitative structure reflects the utility's high cost structure, a somewhat large and cyclical industrial load, and a sluggish local economy. In addition, a determination of stranded cost recovery with impending industry restructuring to introduce direct access in March 2000 as well as Maine Yankee rate recovery treatment remain credit concerns.

The stable outlook reflects expectations of continued financial improvement due to the supportive rate increase and management's efforts to monetize the UNITIL power contract and restructure certain assets. Further financial improvement may be enhanced by the company's generation asset divestiture. Still, the recently enacted restructuring law, although supportive of stranded cost recovery, remains a concern.

The credit report, although not recent, appears consistent with our analysis that the Company's financial condition is weak but improving.

D. Sale of Land at Graham Station

BHE recently closed on the sale of land at Graham Station in Veazie for \$6.2 million, which will be used to reduce the \$45 million loan. We conclude that the reduction of debt is a positive step for BHE, and thus, we consider the news of the Graham Station land sale to be a positive development for BHE.⁶

E. Size of the Investment

⁶ We do not determine in this docket whether BHE was prudent in agreeing to a sale price of \$6.2 million.

BHE has claimed that for the purpose of Commission approval under section 708, the Commission should not consider development costs as investments because: (1) the development costs have already been incurred and recorded as expenses by BHE, and alternatively, (2) if development costs are considered investments, they have already been approved in Phase I of this proceeding. Bangor Gas does not address this issue in its brief other than to state that assuming approval of such costs is necessary, approval should be granted. The Public Advocate states that:

For the purposes of Commission approval under §708 all costs associated with Bangor Hydro's foray into non-core ventures should be considered part of the investment. This should include all amounts identified by the Company in its response to Advisors 5-6. All of these funds would not have been spent but for the Company's decision to seek to make this investment, and thus they are funds that affect the 'reorganization' in terms of whether it is 'consistent with the interests of ratepayers and investors.' Dollars paid to lawyers to pursue regulatory approval for non-core activities, for example, are no different than dollars used to capitalize PNG. Both commit funds which cannot then be used for core functions.

We agree with the Public Advocate. We determine that an investment within the meaning of Chapter 820 and for the purpose of section 708 approval should include all amounts a utility spends or proposes to spend on a non-core venture. This conclusion is consistent with our prior order in this case, the Second Revised Stipulation, and the mandates of section 708 of Title 35-A.

The Second Revised Stipulation clearly considers development costs as an investment by Bangor Hydro for the purposes of section 708 approval. It states the parties' agreement that BHE is permitted to have its "development expenses relating to the Bangor Gas Project, estimated to be \$375,000, credited by Bangor Gas as an investment in Bangor Gas." Second Revised Stipulation, ¶2. Thus, the parties considered development costs to be an investment in Bangor Gas.

The Commission's Order approving the stipulation is consistent with the conclusion that development costs are an

investment requiring our approval. In that Order, we determined that the original stipulation allowed an investment of \$375,000 in development costs as well as a \$600,000 cash investment. Phase I Order at 2, 6. Thus, we considered whether BHE should be allowed to invest \$975,000. We determined that because BHE had not shown that it was or would be in financially sound condition, we could not approve the nearly \$1 million investment pursuant to 35-A M.R.S.A § 708. Phase I Order at 7. We approved the Second Revised Stipulation because it allowed BHE to invest up to \$2.5 million in cash plus \$375,000 in development costs on the condition that it demonstrate that it is in sound financial condition. The Phase I Order required BHE to demonstrate its financial soundness as a condition of approving the entire investment, both development costs and the cash contributions required by the construction budget.

We conclude that both the Second Revised Stipulation and the Order approving it consider development costs as an investment requiring approval pursuant to section 708 and that only conditional approval was granted for the entire investment (\$2.5 million in cash plus \$375,000 in development costs). We therefore reject BHE's claims that section 708 approval is not required for development costs and that if approval is required it has been granted in our Phase I Order. We note however, that even if we had approved the development costs as an investment, we would still consider the aggregate investment in determining whether the next incremental amount should be approved.

We further reject the argument that because BHE chose to expense development costs immediately, such expenditures should not be considered investments requiring section 708 approval. We agree with the Public Advocate that we should consider that such funds were not spent on core operations. Moreover, we agree with the Bench Analysis that the loss of a utility's cumulative investments in the development and capitalization of non-core ventures could damage the Company's credibility in the investment community. Under section 708 of Title 35-A, we are required to determine whether the reorganization will impair the utility's credit or its ability to attract capital on reasonable terms. Thus, we must consider whether the loss of funds invested or spent on the proposed non-core venture, as well as the utility's existing non-core investments, would damage the Company's ability to attract capital on reasonable terms.

In his affidavit, Mr. Samp has identified development costs relating to Bangor Gas as of August 31, 1998, as amounting to approximately \$624,000. Affidavit ¶3. Thus, we determine that the total amount of BHE's proposed investment in BGC for purposes of section 708 review is \$1,224,000.

F. Lending Agreement

In our Phase I Order, we noted that BHE had not yet sought or obtained from the banks that were parties to the credit agreement then in effect permission to make the proposed investment. The Second Revised Stipulation required BHE to provide in its supplemental filing a discussion of the status of any approvals from BHE's financing parties that may be necessary under any BHE credit agreement. In its supplemental filing, BHE asserted that it had permission under its new lending agreement to invest up to \$700,000 in BGC. BHE further asserted at hearing that it did not need lenders' approval to invest the additional \$624,000 in development costs, some of which were already expended at the time the lending agreement was negotiated. We do not express an opinion about whether the parties to BHE's lending agreement intended that development costs should be considered part of an investment requiring approval from the lenders. However, we are concerned about the ramifications for BHE's financial condition of any violation of the lending agreement. Accordingly, we require BHE to ascertain that the expenditure of the full \$1,224,000, including the \$624,000 in development costs, will not violate the terms of the lending agreement.⁷ We condition our approval upon the transaction being consistent with the terms of the lending agreement.

G. Model of Impact of Loss of Total \$1.2 Million Investment in 1998

BHE has provided an affidavit showing the effect of the loss of the total \$1.2 million investment in 1998. This analysis indicates relatively small reductions in its ROE, Earnings Per Common Share, Common Equity Ratio and Pre-Tax Income. As both the Bench Analysis and the Public Advocate observe, however, the analysis does not account for possible loss of credibility in the investment community if such losses are incurred. Nevertheless, we consider the relatively small impact of the investment as one factor supporting our decision to allow the investment.

H. Closing on PERC and UNITIL transaction and Refinancing of Corporate Debt

At the time we issued our Phase I Order, BHE had not yet closed on the PERC and UNITIL transactions. In addition,

⁷We note that the safest way to ascertain that expenditure of the full \$1,224,000, including the \$624,000 in development costs, is consistent with the terms of the lending agreement is through the agreement of the lenders.

principal payments were due on July 1, 1998 under the credit agreement then in effect. The Second Revised Stipulation approved in the Phase I Order thus required BHE to include in its supplemental filing "an update on financing for the PERC transaction and the Unitel monetization." In its supplemental filing, BHE reported that it had closed on the UNITIL and PERC transactions and that it had recently completed a refinancing of its corporate debt. We consider the removal of uncertainty regarding these transactions as one factor in allowing BHE to make the modest investment at issue here.

IV. CONCLUSION

We have determined that BHE's financial condition has improved since March 1998. By no stretch, however, can BHE be viewed as so healthy financially that we should abandon our scrutiny over the size of its investments in non-core activities. Our task here is to determine whether, based on the Company's improved but not yet healthy financial state and the proposed investment of \$1,224,000, we can conclude that the proposed investment is consistent with the interest of ratepayers and shareholders and will not impair BHE's access to capital on reasonable terms, its credit, or its ability to provide safe reasonable and adequate service. 35-A M.R.S.A §708(2)(A). On balance, we agree with the parties that the total \$1,224,000 investment, when considered with the improvement in Bangor Hydro's financial condition and the additional funds from the land sale at Graham Station, allow us to make the findings required under section 708 of Title 35-A. Accordingly, pursuant to Chapter 820, section 708 of Title 35-A and our Phase I Order, we approve an investment by BHE of \$1,224,000 (\$600,000 in cash and approximately \$624,000 in Bangor Gas related development costs).⁸

⁸We do not base our approval in any way upon BGC's assertion that the investment "will in all likelihood, enhance Bangor Hydro's financial position," and that "an investor would support the investment as a proper step towards further and continued improvement in the Company's credit quality." Because our analysis has examined the effect of a total loss of the investment, we do not reach any conclusion here about the riskiness of the venture. We note, however, that in our Order approving BGC's 10 year rate plan we stated, "we are not dealing with an established utility that is operating under rate of return regulation. Rather, as a new company in a competitive environment BGC is quite likely to be found to have somewhat more business risk than [Northern, CMP and BHE]." *Bangor Gas Company. Petition for Approval to Provide Gas Service in the Greater Bangor*, Docket No. 97-795, Order Approving Rate Plan, (June 26,

V. SUBSEQUENT PROPOSED INVESTMENTS

BHE has stated that it may not require approval to make its capital contribution due in April 1999⁹ because Standard & Poor's has indicated that BHE's first mortgage bonds "would be eligible for a rating of one notch above the company's CCR [corporate credit rating]. . ." BHE has stated that "it is more probable that the Company's corporate credit rating would be upgraded to BB+ at the next semi-annual review at the end of 1998. If one assumes that S&P would rate senior bonds at a level one grade above the corporate credit rating, the Company could request and receive an investment grade rating (BBB-) for its first mortgage bonds at that time." We do not decide at this time whether a private rating of BBB- on BHE's First Mortgage Bonds should be considered an investment grade bond rating under Chapter 820. Rather we expect this issue to be litigated if BHE proposes to invest, without Commission approval, additional funds in BGC based on its interpretation of Chapter 820.

BHE has requested that the Commission approve a 90-day time frame for considering its request to make the April 1999 Bangor Gas capital call. BHE states that a 90-day process would allow the Company to file in mid to late January and describe its financial condition at that time based on the most recent information available. It specifically notes that at that time BGC may have identified its construction financing, which would have an impact on the amount of the anticipated Bangor Gas April capital call. We find BHE's request to be reasonable and grant BHE's request for a 90-day review period to consider its request to make additional investments in Bangor Gas in April of 1999.

Accordingly, we

O R D E R

1. That Bangor Hydro-Electric Company may invest \$1,224,000, including \$624,000 in already expended development costs, in Penobscot Natural Gas for investment in Bangor Gas Company as described above in this Order and consistent with the provisions of the Second Revised Stipulation approved in the Phase I Order in this matter.

Dated at Augusta, Maine, this 30th day of October, 1998.

1998), Order at 25.

⁹It appears that BHE may be asked to make capital contributions of between \$7 million and \$10 million in 1999.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.